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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 177

MARY E. WENGER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

HENRY B. GRAVES,
Counsel for Petitioner.

CHARLES H. HATCH,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 177

MARY E. WENGER,
Petitioner in this Court and also below,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent in this Court and also below.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable Supreme Court of the United States:

Your petitioner respectfully shows:

SECTION I.

Summary Statement of the Matter Involved.

By a letter dated November 18, 1937 set out in the petition filed with the Board of Tax Appeals (See Sec. II, R. 3; admitted in Commissioner's Answer Sec. II, R. 27; Exhibit A, R. 16) the Commissioner of Internal Revenue

notified the petitioner herein that the determination of her income tax liability for the taxable years ended December 31, 1934, and December 31, 1935, disclosed a deficiency of $6,780.89 (R. 16), for 1934, $2,350.04; for 1935, $4,430.85 (R. 17).

The reason assigned was that under a trust instrument set forth in the record (R. 37) as Exhibit A annexed to and a part of a stipulation of facts Section I (R. 30) executed by the petitioner Mary E. Wenger, as settlor, to A. W. Wenger as trustee, dated January 3, 1932 (R. 37), the trustee might distribute the entire income of the trust to Mrs. Wenger, and that therefore the trust instrument fell squarely within section 167 (a) (2) of the Revenue Act of 1934 (Act of May 10, 1934, C. 277, 48 Stat. 680 at pp. 729, 730) (R. 19, 20). The Commissioner further held that the fact that under the trust instrument the "distribution of the trust income could only be made at the discretion of the trustee" was no objection to this conclusion "for the trustee does not have an adverse interest" (R. 20).

For the complete text of Revenue Act of 1934, Sections 166 and 167, see R. 63.

On February 9, 1938, the petitioner herein filed her petition with the Board of Tax Appeals praying for a redetermination of the amount of her income taxes for the years 1934 and 1935 (R. 3).

The Commissioner of Internal Revenue answered the last mentioned petition (R. 26); and before the Board of Tax Appeals a stipulation of facts was filed (R. 29) and oral testimony given (R. 84). The Board of Tax Appeals rendered a finding of facts and opinion (R. 57; 42 B.T.A. 425) holding that the income of the trust for the years 1934 and 1935 was taxable to the petitioner under both Sections 166 and 167 of the Revenue Act of 1934 (R. 68).

The Board of Tax Appeals held that under Section 167 of The Revenue Act of 1934, one-half the income of the

trust for the years 1934 and 1935 was taxable to the petitioner herein because the trustee was without a substantial adverse interest (citing Reinecke v. Smith, 289 U. S. 172) and had the power to make such distribution (R. 65).

The Board of Tax Appeals also held that because under paragraphs G (1) and (2) of the trust instrument (R. 42) the trustee had power, in his discretion under certain circumstances, to distribute to the petitioner herein current income, accumulated income and corpus, and because the trustee was without a substantial adverse interest, all the income of the trust for the years 1934 and 1935 was taxable to the petitioner herein under both Sections 166 and 167 (R. 67).

The Board of Tax Appeals held certain losses deductible (R. 68, 69); a recomputation being made in consequence, the Board of Tax Appeals, on August 13, 1940, entered its decision that there was a deficiency in income for the year 1934 of $1,181.28, and for the year 1935 of $3,268.51 (R. 70).

On November 6, 1940, the petitioner herein filed her petition for a review by the United States Circuit Court of Appeals for the Sixth Circuit of the decision of the Board of Tax Appeals (R. 71).

The Circuit Court of Appeals for the Sixth Circuit heard the case, but filed no opinion. That court on April 7, 1942, made an order affirming the decision of the Board of Tax Appeals. The order, duly certified, is in the Record following page 91, and is reported as *Wenger* v. *Commissioner of Internal Revenue,* 127 F. 2nd 523. From the recitals in that order, it appears that the court found that the power to make distribution of the income or corpus of the trust to the petitioner herein was in the petitioner, and that the trustee had no substantial adverse interest in the disposition of the income or corpus of the trust property, and in that connection referred to Sections 166 and 167 of the Revenue Act of 1934 and the cases of *Reinecke* v. *Smith,*

289 U. S. 172, and *Altmaier* v. *Commissioner,* 116 F. 2d 162, 164 (C. C. A. 6).

It thus appears that the Commissioner of Internal Revenue, The Board of Tax Appeals, and the Circuit Court of Appeals all held that under the trust instrument of January 3, 1932 the trustee, in respect of the distribution of the income and corpus of the trust, was without adverse interest to the petitioner herein.

Error on this point was assigned in the Court of Appeals (R. 76, Assignment 7; R. 78, Assignments 16, 17; R. 79, Assignment 18; R. 81, Assignments 35, 38).

The principal question involved in said petition to the United States Circuit Court of Appeals for the Sixth Circuit was whether the trustee under said trust instrument was a person with a substantial interest in the distribution of the income and corpus of the trust adverse to the petitioner herein, and the decision of that question by the court materially affected the said affirmation of the decision of the Board of Tax Appeals.

The Trust Instrument.

The trust instrument dated January 3, 1934, executed by the petitioner herein, Mary E. Wenger, as grantor, to A. W. Wenger, trustee as grantee (R. 37), transferred securities of the market value of about $400,000.00 (R. 87) consisting in greater part of bonds (R. 38). All power of management is given to the trustee (R. 40, 41). The trust is to terminate in 15½ years from the date of the trust instrument unless sooner terminated by consent of the grantor and her four children and the trustee, or by the consent of the trustee and the grantor and the living children; or by the death of all the children prior to the expiration of the said period of 15½ years; or by the death of the grantor prior to the expiration of said 15½ years if all the children then living shall have attained 35 years

of age and shall have received conveyance to them by the trustees of their father's will of the property held by the latter trustees in which the children are interested as beneficiaries (R. 41).

Upon the termination of the trust, the accumulated income and corpus is to be distributed as provided in Section H of the trust instrument (R. 43).

The settlor was 69 years of age in September, 1939 (R. 30, Section III). The four children respectively became, or will become 35 years of age in November, 1935, September, 1940, August, 1942, March, 1947 (R. 30, 31, Section IV).

The motives of the settlor in creating the trust are set out in Sections B and C of the trust instrument (R. 38, 39, 40). Full powers of management are conferred on the trustee by Sections D and E, and no such powers are reserved to the settlor (R. 40, 41).

The powers and duties of the trustee respecting distribution of income and corpus are of two classes:

(1) Distribution to the settlor and her four children, which the trustee is permitted to make in his discretion;

(2) Distribution to the children which the trustee is required to make.

The terms of the trust instrument setting forth these powers of distribution are as follows:

> "G. Distribution from the income of the Trust Estate shall be made by the trustee and/or his successors as follows:
>
> "(1) In the event any accident, sickness, calamity, misfortune, adversity, bereavement or loss, financially or otherwise, shall visit, overtake or befall the maker hereof and/or any of her children, or their descendants, then and in that event the said Trustee may distribute to such beneficiary or beneficiaries hereof, upon her, his or their written request or requests, such sum

or sums which in the discretion of said Trustee, will be sufficient to alleviate, aid and relieve such beneficiary or beneficiaries from such misfortune or happening.

(2) In the event it should occur that any one or more of said children should suffer loss in the investment of funds received by them respectively from the Estate of Emil P. Wenger, deceased, at the time they respectively reached the ages of twenty-five and thirty years, after having followed advice given by the maker, regarding the investment of said funds, (as more particularly set forth in the early part of this Trust Agreement) then upon written request of any of such beneficiaries to the Trustee, he shall pay to any such beneficiary such sum or sums of money necessary to enable such beneficiary or beneficiaries to recoup such losses suffered by them respectively and thus place them in a situation where they will not run the risk of losing their right to demand and receive a conveyance to them respectively of the corpus of their respective Trust Estates, upon reaching thirty-five years of age.

It is not intended that the relief contemplated to be afforded by the above sections shall be limited merely to the accrued and accumulated income from the Trust Estate, but the Trustee is granted the right, power and authority of encroaching upon the principal of the Trust, should the income be insufficient at such time for the purposes set forth, and the gravity of the situation demands that the aid be furnished.

(3) In the event the earnings, income, rents, receipts and profits received by the Trustee, during any year, are sufficient in amount so that in the judgment of said Trustee it would be advisable to make a distribution of part or all of such surplus income, the Trustee shall be authorized to pay out and distribute all, or any part thereof, to the beneficiaries hereof in the following proportions; One-half of any

sum determined upon to be distributed, to the maker hereof, Mary E. Wenger; and the other half equally between my children, Alice E. M. Sandonnini, E. Boyer Wenger, P. Cedric Wenger and Louise Wenger, or the survivors. Provided, that if any of such children should die prior to the termination of this Trust, but leave a child or children surviving, then the share which would have been payable to the parent, if he or she were living at the time of such distribution, shall be payable to such issue per stirpes."

The will of Emil P. Wenger, deceased, (father of the children, as alleged in the petition to the Board of Tax Appeals, Section V, R. 6, and admitted in the Commissioner's Answer, Section V, R. 28) referred to in the trust instument in Section C (R. 39) and also in Section G (2) (R. 42) is Exhibit B (R. 48) attached to and a part of the stipulation of facts (R. 30, Section II).

Section II.

Questions Involved.

1. The principal question involved is whether the trustee, in making distribution of income and corpus of the trust, is a person having a substantial interest adverse to the petitioner, Mary E. Wenger.

2. The answer to that question depends upon the answer to the further question of what duty the trustee owed to the children who were beneficiaries of the trust, to so exercise his powers and the discretion given him by the trust instrument to conserve the income and corpus of the trust to the end that benefits to the children intended to be conferred by the trust may be enjoyed by them, and the liability of the trustee to account to the children in equity for a failure to perform that duty.

If such a duty rested on the trustee, and he was liable to account in equity to the children for a failure to perform it, he was interested adversely to Mrs. Wenger in the exercise of his discretion in determining what distribution to make to her.

Section III.

Reasons Relied On for the Allowance of the Writ.

1. The authority cited by the tribunals below for holding that the trustee was not adversely interested to the settlor is *Reinecke* v. *Smith*, 289 U. S. 172 (Commissioner's letter, R. 20; Board of Tax Appeals Opinion, R. 65; Order of the Circuit Court of Appeals, Record following p. 91). The citation of that case as authority in this connection is a misapplication thereof for it did not decide the questions here presented.

2. The United States Circuit Court of Appeals for the Sixth Circuit in this case has rendered a decision in conflict with the decision of the United States Circuit Court of Appeals for the Seventh Circuit on the same matter in *Stuart* v. *Commissioner of Internal Revenue*, 124 F. 2d 772.

Wherefore, your petitioner prays that a Writ of Certiorari issue under the seal of this court directed to the United States Circuit Court of Appeals for the Sixth Circuit commanding said court to certify and send to this court a full and complete transcript of the Record and of the proceedings of said United States Circuit Court of Appeals for the Sixth Circuit had in the case numbered and entitled on its docket No. 8876, *Mary E. Wenger, Petitioner,* v. *Commissioner of Internal Revenue, Respondent,* to the end that this cause may be reviewed and determined by this court as provided by the statutes of

the United States; and that the judgment herein of the United States Circuit Court of Appeals for the Sixth Circuit be reversed by this court, and for such further relief as to this court may seem proper.

Dated June 22, 1942.

MARY E. WENGER,
Petitioner;

By HENRY B. GRAVES,
Counsel for Petitioner,
CHARLES H. HATCH,
Of Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinion and Order of the Courts below.

Opinion of Board of Tax Appeals, R. 63.

Findings of Fact of B. T. A., R. 58, reported 42 B. T. A. 225.

> [The findings of fact and opinion of the Board commenced at R. 58, line 21; paragraphs numbered 1, 2 and 3, R. 57, 58 are the syllabus as printed in 42 B. T. A. Reports 225.]

Order of the United States Circuit Court of Appeals for the Sixth Circuit, Record following page 91, reported 127 F. (2d) 523. [That court rendered no opinion.]

II.

Jurisdiction.

1. The date of the judgment to be reviewed is April 7th, 1942 (Record following p. 91).

2. The statutory provision, which is believed to sustain the jurisdiction of this Court, is sub-section (a) of Section 240 of the Judicial Code as amended by 36 Stat. 1157; 43 Stat. 938; 45 Stat. 54; 48 Stat. 926 (28 U. S. C. A. § 347) reading, so far as applies to this case, as follows:

> "In any case, civil or criminal, in a Circuit Court of Appeals * * *, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by

it with the same power and authority and with like effect, as if the cause had been brought there by unrestricted appeal."

3. This is a civil case in the United States Circuit Court of Appeals for the Sixth Circuit (see proceeding in that court in the record following p. 91). This petitioner is a party thereto (see petition for review, R. 71); and this petition is filed after judgment by the lower court and within three months after that judgment (R. following p. 91, and 28 U. S. C. A. § 350 as amended by 45 Stat. 54; 48 Stat. 926).

III.

Statement of the Case.

The case has already been stated in Section I of the preceding petition (ante pp. 1 to 7) which is hereby adopted and made a part of this brief.

IV.

Specifications of Error.

1. The United States Circuit Court of Appeals for the Sixth Circuit erred in holding that the trustee under the trust instrument in this case (R. 37) in the exercise of his power as trustee to distribute income and corpus of the trust to petitioner and her children had no substantial interest adverse to the settlor, the petitioner herein.

2. Said Court of Appeals erred in not holding that the duty of the trustee under said trust instrument, in exercising his discretion in distributing income and corpus of the trust, to conserve the income and corpus of the trust to the end that the children may fully enjoy the benefits which it is the purpose of the trust to confer upon them, made

the trustee a person having a substantial interest adverse to the settlor within the meaning of Sections 166 and 167 of the Revenue Act of 1934.

V.

Argument.

The argument, summarily stated, is that the trustee, in the exercise of his discretion to make distribution of income and corpus of the trust to the settlor as a beneficiary, owed a duty to the children, the other beneficiaries, to limit the distributions to the settlor, not only to such payments to the settlor as are specified by the terms of the trust, but also to such payments as would leave funds sufficient to satisfy all the rights and interests of the children in the income and corpus which it is the intent of the trust instrument to confer upon them; that a failure by the trustee to perform this duty made him pecuniarily liable to the children; that this liability, equity would enforce against him at the instance of the children, and that therefore the trustee is interested adversely to the settlor in respect of any distribution he made to her.

The smaller the payments by the trustee to Mrs. Wenger during the continuance of the trust, the greater the amount that each child will receive at the termination of the trust, and it is the duty of the trustee to exercise a sound and reasonable judgment in protecting this interest of the children.

The trust was for the benefit of the children as well as the settlor.

A purpose of the trust is declared in Section B of the instrument to be for "alleviating the wants and needs of herself and children" (R. 38); a reason for creating the trust stated in Section C. 1 (R. 38) is the situation of the settlor and the children. The reason stated in Section

C. 2 (R. 38, 39) is the nature of the provisions of Emil P. Wenger's will, which affects the children alone and not the settlor. By Section G (1) (R. 42) if certain things happen to "the maker hereof and/or any of her children, or their descendants," the trustee may [the word "may" gives authority or permission merely] distribute to such beneficiary or beneficiaries "sums" which in the discretion of the trustee will be sufficient for certain purposes (R. 42). By Section G (2) (R. 42, 43), if certain things happen to the children, or any of them (which can happen to the children only and not to the settlor) the trustee "shall [This is an imperative command to the trustee.] pay to any such beneficiary [This term here means one or more of the children and not the settlor.] such sum or sums of money necessary to enable such beneficiary or beneficiaries to recoup" certain specified losses. [These terms do not give the trustee any discretion as to the amounts he shall pay for the benefit of the children; the whole loss is to be made good (R. 42, 43).]

These provisions of the trust instrument are followed by a paragraph (R. 43) granting the trustee "right, power and authority of encroaching upon the principal of the trust" on condition, however, that the income is not sufficient for the purposes contemplated by these provisions, "and the gravity of the situation demands that the aid be furnished" (R. 43).

Section G (3) provides that if the income during any year is such "that in the judgment of said trustee it would be advisable to make a distribution of part or all of such surplus income" the trustee is authorized to make distribution of all or part thereof (R. 43).

Upon the termination of the trust, distribution of the trust funds is to be made by the trustee as provided in Section H (R. 43). In making it, the trustee will have many questions of value to decide between Mrs. Wenger

and the children. The less the payments to Mrs. Wenger during the continuance of the trust, the more there will be to distribute to each child at its termination. It is the duty of the trustee to conserve this interest; in favoring Mrs. Wenger he must not sacrifice the children or their descendants.

We submit, therefore, that the trust instrument imposes substantial duties on the trustee to protect and conserve interests of the children as opposed to interests of the settlor, and that this fact makes him a person endowed with a substantial interest adverse to the settlor.

Where broad powers are conferred upon a trustee to be exercised in his discretion, a court of equity has power to control the administration of the trust to the end that the purposes for which the trust was created may be attained. In *Stuart* v. *Commissioner,* 124 F. 2d 772, at p. 777, the Circuit Court of Appeals of the 7th Circuit said:

> "A court of equity has power to control the administration of a trust so that it will accord with the purposes of the grantor. A discretion lodged in a trustee is rarely, if ever, to be regarded as a permit to act arbitrarily. Such discretion should be confined to the exercise of judgment not unreasonable in the light of the purposes of the trust and of the circumstances in which it is sought to be exercised. The power of the court exists solely for the protection of the right of the grantor and the beneficiaries (see Rollins *v.* Helvering [92 F. 2d 390])."

Under this doctrine it was held in that case, where the settlor, his wife, and his brother were the three trustees, and the trust instrument provided that the wife and brother, or the survivor of them, should have the power to change the beneficiaries or change the trust indenture in any other respect, that, nevertheless, the wife and brother had no authority to revest the property either in

themselves or the grantor on the ground that this would "give them power, not only to destroy the trust but to dissipate the proceeds contrary to the purposes set forth in the declaration, and it would also furnish an opportunity by secret agreement for subsequent distribution among the trustees. Such a door should not be left open. Congress and the courts, theoretically at least, have always regarded the preservation of trust funds as a sacred obligation, and they have always and everywhere proceeded on the theory that a trust officer should not be permitted to be placed in any position where he may be 'tempted above that which he is able'."

In 65 Corpus Juris, page 648, it is said that a trustee's duties require that he represent and protect the interests of all the beneficiaries impartially, and that he act honestly and with the utmost good faith.

In *Lovett* v. *Farnham*, 169 Mass. 1, the syllabus reads in part:

> "The amount spent by the trustee under a discretionary power of what is needed, must be founded on a reasonable judgment, dealing with existing facts, and having a due regard for the purposes for which the power was given, and also for the rights of those whose interests are injuriously affected by its exercise."

It has been held that if the power is given to use trust funds in case of need to support the beneficiary, it can only be used upon the happening of such a necessity, and cannot be used to supply the beneficiary with money in invest or to draw out all the trust funds and so terminate the trust. In the matter of Wentworth, 230 N. Y. 176.

The discretion vested in a trustee is subject to the control of a court of chancery.

Maguire v. *City of Macomb*, 293 Ill. 441;
Welch v. *Caldwell*, 226 Ill. 488;
Jones v. *Jones*, 124 Ill. 254;

Frank v. *Frank*, 305 Ill. 181;
Restatement of Law of Trusts, Sec. 170;
Wales v. *Gray*, 109 Mich. 346;
Scott on Trusts, Vol. 2, Sec. 187;
Gibney v. *Allen*, 156 Mich. 301 at p. 312;
65 Corpus Juris, pp. 647, 648, Sec. 519;
In re Thompson's Estate, 262 Pa. 278;
Patterson v. *Old Dominion Trust Co.*, 139 Va. 246;
In re Fox's Estate, 264 Pa. 478;
Holian v. *Holian*, 265 Mass. 563;
Congdon v. *Congdon*, 160 Minn. 343.

In *Corning* v. *Commissioner* (C. C. A. 6), 104 F. 2d 329, it was held that right in a beneficiary to receive current income made the beneficiary one having an adverse interest. We submit that it follows from this that a trustee, whose duty it is to protect the right of a beneficiary to receive income or corpus, must also have an adverse interest.

In *Phebe Warren McKean Downs* v. *Commissioner*, 36 B. T. A. 1129, at p. 1134, it was said that a trust instrument is always construed against the grantor and in favor of the beneficiaries. In the instant case that would be against the settlor and in favor of the children.

The only decision of the court cited below to the point that the trustee is without adverse interest is *Reinecke* v. *Smith*, 289 U. S. 172; the Court of Appeals cites that case and *Altmaier* v. *Commissioner*, 116 F. 2d 162, 164.

Reinecke v. *Smith* does not decide that a trustee cannot be adversely interested; indeed the implication from the ground of the decision is that he might be. The case arose under Section 219 (g) of the Revenue Act of 1924 (Act of June 2, 1924, C. 234, 43 Stat. 253-355) the words of which pertinent here are:

> "Where the grantor of a trust has, * * * either alone or in conjunction with any person not a bene-

> ficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust * * * shall be included in computing the net income of the grantor."

The trust instrument there involved provided for its modification or revocation by an instrument in writing signed by the settlor (who was one of three trustees) and either one of two other trustees. The court said that a trustee is not a beneficiary, and also said:

> "The trustee is not a trustee of the power of revocation and owes no duty to the bneficiary to resist alteration or revocation of the trust. Of course he owes a duty to the beneficiary to protect the trust *res*, faithfully to administer it, and to distribute the income; but the very fact that he participates in the right of alteration or revocation negatives any fiduciary duty to the beneficiary to refrain from exercising the power."

This then is a decision that the power to revoke lodged in a person who at the same time may be a trustee is not a fiduciary power; its exercise is not part of the administration of the trust; but it also is an assertion that the trustee does owe duties to the beneficiaries in the administration of the trust. The trustee in the instant case has no power to revoke, nor has the settlor; the trustee has powers and duties of management and distribution in the exercise of which equity will require him to deal justly with due regard to the conflicting interests of the several beneficiaries and to the achievement of all the purposes of the trust.

The trust instrument in *Altmaier* v. *Commissioner* (C. C. A. 6), 116 F. 2d 162, is, we submit, so radically different in its terms and purposes from the trust instrument now in question that it should not be held a precedent for the instant case. There the trust could be destroyed under the unequivocal terms of the trust instrument—here the purpose of the continuance of the trust for a long term, and

the intention to confer substantial beneficial interests on the children, which it is the duty of the trustee to protect, is plain; under the decision in *Stuart* v. *Commissioner*, 124 F. 2d 772 in the 7th Circuit, equity will not permit the trustee to act so as to destroy the trust; if *Altmaier* v. *Commissioner* holds otherwise, we have a conflict of decision between the Courts of Appeal of the 6th and 7th Circuits.

That the principles of equity jurisprudence as applied to the law of trusts prevail in the Federal as well as State jurisdictions is sanctioned by this Court.

Freuler v. *Helvering*, 291 U. S. 35;
Blair v. *Commissioner*, 300 U. S. 5;
Morgan v. *Commissioner*, 309 U. S. 78;
Stuart v. *Commissioner* (C. C. A. 7) 124 F. 2d 772.

Conclusion.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers by granting a writ of certiorari, and thereafter reviewing said decision.

HENRY B. GRAVES,
Counsel for Petitioner.

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No. 177

In the Supreme Court of the United States

OCTOBER TERM, 1942

MARY E. WENGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 177

MARY E. WENGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 92–93) is reported at 127 F. (2d) 523. The opinion of the Board of Tax Appeals (R. 57–70) is reported at 42 B. T. A. 225.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 7, 1942 (R. 92–93). The petition for a writ of certiorari was filed June 24, 1942, and notice was served July 7, 1942. The jurisdic-

tion of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the income of a trust created by the petitioner for the benefit of herself and her children is taxable to the petitioner under Section 166 or 167 of the Revenue Act of 1934. The question depends upon whether the trustee, who is petitioner's nephew and adviser and not a beneficiary, has a substantial adverse interest in the disposition of the income or corpus by reason of his fiduciary obligations to petitioner's children.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved are set forth in the Appendix, *infra,* pp. 9–13.

STATEMENT

Petitioner is the widow of Emil P. Wenger who died testate June 2, 1916, survived by petitioner and their four children. Petitioner and the four children are beneficiaries of trusts created for them by the will of Emil P. Wenger (R. 59).

On January 3, 1932, petitioner, who then was sixty-two years of age, executed a deed of trust (R. 37–47) conveying to her nephew and adviser, A. W. Wenger, as trustee, certain securities having a value of approximately $400,000. The stated

purpose of the trust was to provide means which would be available for alleviating the needs and wants of petitioner and her children in the event that their income from the trusts created by petitioner's husband were reduced or in the event of other contingencies (R. 38–40). Full powers of management were granted the trustee, but neither he nor anyone else had the power to change the beneficiaries. The trust was to continue for fifteen years and six months unless terminated sooner by the mutual consent of petitioner, her four children, and the trustee or his successor; by mutual consent of petitioner, the survivors or survivor of her children, and the trustee or his successor; by the death of all of her children prior to the time fixed for the termination of the trust; or, under certain circumstances, by the death of petitioner prior to the date specified for the termination of the trust (R. 41–42). Upon termination of the trust the corpus and undistributed income were to be paid in equal shares to all or some of the beneficiaries, depending upon the manner of termination (R. 43–45).

If during the life of the trust any of the children suffered losses in the investment of funds received from their father's estate and if certain other conditions were met, the trustee was directed to pay such beneficiary or beneficiaries enough out of the trust to enable the losses to be recouped (R. 42–43). In addition, the trust

(Paragraph G (1)) contained the following provision (R. 42):

> In the event any accident, sickness, calamity, misfortune, adversity, bereavement or loss, financially or otherwise, shall visit, overtake or befall the maker hereof and/or any of her children, or their descendants, then and in that event the said Trustee may distribute to such beneficiary or beneficiaries hereof, upon her, his or their written request or requests, such sum or sums which in the discretion of said Trustee, will be sufficient to alleviate, aid and relieve such beneficiary or beneficiaries from such misfortune or happening.

It was specified that in making such distributions the trustee had authority to encroach upon the corpus of the trust "should the income be insufficient at such time for the purposes set forth and the gravity of the situation demands that the aid be furnished" (R. 43).

The trust (Paragraph G (3)) also provided (R. 43):

> In the event the earnings, income, rents, receipts and profits received by the Trustee, during any year, are sufficient in amount so that in the judgment of said Trustee it would be advisable to make a distribution of part or all of such surplus income, the Trustee shall be authorized to pay out and distribute all, or any part thereof, to the beneficiaries hereof in the following propor-

> tions; One-half of any sum determined upon to be distributed, to the maker hereof, Mary E. Wenger; and the other half equally between my children * * *

At the time of the present suit all of the income of the trust had been accumulated and none had been distributed (R. 61). The Commissioner of Internal Revenue added to petitioner's reported income for 1934 and 1935 the income of the trust during those years and determined deficiencies in the respective amounts of $2,350.04 and $4,430.85 (R. 16–26). These deficiencies were determined without giving effect to certain losses sustained by the trust which petitioner claimed should be allowed as deductions in computing her net taxable income if the trust income was taxable to her (R. 61).

The Board of Tax Appeals held that the income of the trust was taxable to petitioner for the years involved. After ordering adjustment for deductible losses sustained by the trust in those years, it redetermined deficiencies in the respective amounts of $1,181.28 and $3,268.51 (R. 57–70). The Circuit Court of Appeals for the Sixth Circuit affirmed the Board's decision (R. 92–93).

ARGUMENT

Section 166 of the Revenue Act of 1934 (Appendix, *infra*, p. 9) provides that the income of a trust shall be taxed to the grantor where at any

time, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the corpus or income therefrom, he has power to revest the title to the corpus in himself, or where such power is vested in another person not having any such substantial adverse interest.

The Board and court below both held petitioner taxable under this section.[1] They concluded first that the wording of Paragraph G (1) (*supra*, p. 4) of the trust here involved was sufficiently broad to permit petitioner, with the acquiescence of her nephew as trustee, to use the income and if necessary the corpus for needs for which she normally would have used the property had no trust been created. Secondly, they concluded that petitioner's nephew as trustee had no substantial adverse interest in the disposition of the income or corpus (R. 65, 67–68, 92–93).

Petitioner does not now question the propriety of the first of the foregoing conclusions, but contends (Pet. 7, 12–14) only that her nephew as trustee did have a substantial adverse interest sufficient to render Section 166 inapplicable. This

[1] The Board also held (R. 65) that independently of Section 166 petitioner was taxable on one-half of the income from the trust under Section 167 of the Act (Appendix, *infra*, pp. 9–10) in view of the provisions of Paragraph G (3) (*supra*, pp. 4–5) of the trust empowering the trustee to distribute one-half of the income to petitioner. The court below did not discuss the point but held Section 167, as well as Section 166, applicable (R. 93).

contention is based solely on the ground that as trustee he owed certain fiduciary duties to protect the interests of the children as well as those of petitioner, the other beneficiary, and that their interests were opposed to those of petitioner in that payments to petitioner would reduce the amount available for payment to the children. Such an argument, however, could be made with respect to any trustee, whereas it is settled that a trustee has a "substantial adverse interest" only if he is himself a beneficiary or has some other direct personal interest adverse to that of the settlor. *Commissioner* v. *Caspersen,* 119 F. (2d) 94 (C. C. A. 3), certiorari denied, 314 U. S. 643; *Altmaier* v. *Commissioner,* 116 F. (2d) 162 (C. C. A. 6), certiorari denied, 312 U. S. 706; *Morton* v. *Commissioner,* 109 F. (2d) 47, 51 (C. C. A. 7); *Fulham* v. *Commissioner,* 110 F. (2d) 916, 918 (C. C. A. 1). Cf. *Reinecke* v. *Smith,* 289 U. S. 172; *Helvering* v. *Evans,* 126 F. (2d) 270 (C. C. A. 3); *White* v. *Higgins,* 116 F. (2d) 312, 318 (C. C. A. 1).[2]

The trustee in this case was not a beneficiary and had no other direct personal interest in the corpus or income adverse to that of petitioner. Nor did he have the power to change the beneficiaries. For this reason the decision of the

[2] See also H. Rep. No. 708, 72nd Cong., 1st Sess., p. 25 (1939–1 Cum. Bull. (Part 2) 457, 474–475) and S. Rep. No. 665, 72nd Cong., 1st Sess., pp. 34–35 (1939–1 Cum. Bull. (Part 2) 496, 520–521).

court below does not conflict with *Stuart* v. *Commissioner,* 124 F. (2d) 772 (C. C. A. 7), certiorari granted April 27, 1942, Nos. 48 and 49, present Term. The trust instrument in that case gave the trustees the right to change the beneficiaries and the court held (p. 777) that if they had the power to substitute themselves as beneficiaries they were adversely interested. The court did not hold that in the absence of such a power the fiduciary obligations of the trustees toward the beneficiaries other than the settlor were alone sufficient to give the trustees a substantial adverse interest, and, so far as we are aware, no other court has reached such a result.

CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted.

OSCAR COX,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
GERALD L. WALLACE,
F. E. YOUNGMAN,
Special Assistants to the Attorney General.

JULY 1942.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

* * * * *

then such part of the income of the trust

shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question".

Treasury Regulations 86, as originally promulgated under the Revenue Act of 1934:[1]

ART. 166–1. *Trusts in the corpus of which the grantor retains an interest.*—(a) *Scope.*—Section 166 prescribes that the income, or any part of the income, of certain trusts shall be taxed, not to the trustee nor to the beneficiaries, but to the grantor because of the fact that the grantor has retained a certain interest in the property of the trust. This article deals with the taxation of such income. The term "corpus," as used in this article, means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) *Test of taxability to the grantor.*—The sufficiency of the grantor's retained interest in the corpus resulting in the taxation of its income to the grantor is determined by a single test, namely, whether the grantor has failed to divest himself, permanently and definitively, of every right which might by any possibility enable him once

[1] Art. 166–1 was amended on March 7, 1936, by T. D. 4629, XV–1 Cum. Bull. 140 (1936). Art. 167–1 was amended by T. D. 4759 on September 7, 1937, 1937–2 Cum. Bull. 117, and by T. D. 4860 on September 12, 1938, 1938–2 Cum. Bull. 184. No question in the case turns upon any change in the Regulations made by these amendments.

more to possess and enjoy in title the trust corpus. For the purposes of this article the sufficiency of the grantor's retained interest in the corpus is not affected by the fact that the grantor has provided that the right to cause the title to the corpus to revest in himself is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the corpus or income therefrom adverse to the grantor.

If the grantor has retained any such interest in the corpus he is taxable on the income therefrom regardless of—

(1) how great or how small, how remote or how contingent the interest may be;

(2) whatever the nature of interest retained may be; whether the interest retained is vested, contingent, in reversion, or otherwise; whether conditioned on the precedent giving of notice, or on elapsing of a period of years, or on the happening of a specified event; whether taken by appointment, or by designation in the trust instrument, or merely by virtue of the grantor not conveying his whole estate in the corpus, or otherwise;

(3) the time or times at which such interest will revest the title in the grantor in possession and enjoyment, whether within or without the taxable year, whether or not the time be fixed, determinable or certain to come;

(4) whether, if the revesting in the grantor of title to the corpus is in any way dependent upon the act of anyone, that person be the grantor, or any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or both. A bare legal interest, such as that

of a trustee, is never substantial and never adverse;

(5) when the trust was created.

* * * * *

ART. 167–1. *Trusts in the income of which the grantor retains an interest.*—(a) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(b) *Test of taxability to the grantor.*—The test of the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether the grantor has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have the income, at some time, distributed to him, actually or constructively. Such a distribution to the grantor occurs if the income is paid to him or to another according to the grantor's direction or if, though paid to another pursuant to the terms of the trust, the benefit of the income inures to the grantor. The income so inures if it is or may be applied in satisfaction of a legal obligation of the grantor, does or may increase his net worth, does or may in any way enrich him, or does or may enable him in any way to enjoy, in substance, such income. Such a distribution also occurs if the income is applied

in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

* * * * *

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 177

MARY E. WENGER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On petition for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

REPLY BRIEF FOR PETITIONER IN SUPPORT

HENRY B. GRAVES,
Counsel for Petitioner.

CHARLES H. HATCH,
Of Counsel.

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Error in the Petition

At page 4, line 21, for "1934" read "1932."

Argument

I.

In the brief for respondent, at page 6 it is stated that the petitioner's contention is that the trustee has a substantial adverse interest sufficient to render Section 166 of the Revenue Act of 1934 inapplicable. In fact the petitioner contends that the trustee's interest was also sufficient to render Section 167 of that Act inapplicable.

Section 166 concerns corpus of the trust only, and Section 167 concerns income only.

(For the Revenue Act of 1934, see 48 Stat. 680. Sections 166 and 167 are set forth in full in the record at p. 63, and the pertinent parts in brief for respondent pp. 9, 10.)

If this contention is sustained, the court below was in error in holding the petitioner taxable on one-half of the income from the trust (Respondent's brief, p. 6, note 1) as well as in holding Section 166 applicable.

Distributions of income and corpus are controlled by Section G of the trust instrument (R. 42, 43; set out in the brief in support of the petition pp. 5, 6, 7). Under these provisions the settlor, acting alone, cannot cause any distribution to be made to herself; all distributions to her, as well as distribution of one-half of "surplus income" under Section G (3) (R. 43), as all other distributions, are subject to the judgment and discretion of the trustee (Petitioner's brief in support of the petition, p. 13).

The petitioner's contention is that both as to corpus and income, the trustee, on the question of making distribution to Mrs. Wenger, is substantially interested adversely to her; that this interest is more than the "bare legal

interest, such as that of a trustee" which is stated in Treasury Regulations 86, Art. 166-1 (b) (4), Art. 167-1 (b) (3) (set out in respondent's brief pp. 11, 12 and 13) as "never substantial and never adverse."

II.

At page 6 of respondent's brief it is said that the petitioner does not question the propriety of the Board's conclusion that by paragraph G (1) of the trust instrument herein, the petitioner was permitted, with the acquiescence of the trustee to use the income, and if necessary the corpus for needs for which she normally would use the property had no trust been created. On the contrary, the petitioner does question the propriety of that conclusion.

The trust was created expressly for the benefit of the petitioner's children as well as for herself (Section B, R. 38); to make special funds available "in case of necessity for alleviating the needs and wants of [the petitioner] and children in event contingencies as hereinafter set forth should arise" (Section B, R. 38); that the income of the trust "may be available to insure, as far as humanly possible against suffering, want and deprivation by the maker and her children" (Section C 1, R. 38); to protect the children from what they may suffer by reason of certain provisions of their father's will (Section C. 2, R. 38, 39, 40).

We submit that the interpretation placed upon Section G (1) (R. 42) by the Board in its opinion (R. 67) is not correct. Section G (1) authorized (did not direct) the trustee in his discretion to pay such sums as will be sufficient "to alleviate, aid and relieve such beneficiary or beneficiaries from such misfortune or happening" (R. 38)

and these terms should be interpreted and limited by the terms expressing the purposes of the trust in Sections B and C, particularly Section C 1 (R. 38).

If the interpretation placed by the Board (R. 67) on Section G (1) (R. 42) be true, still the Board and the Court below are in error. The Board said (R. 67 line 36):

> "Experience convinces us that the normal life of any individual, no matter how protected, sheltered and circumstanced, contains in every year some occurrence or event which would fall within one of the conditions described."

If this is true, it would not necessarily involve the distribution to Mrs. Wenger of the whole income and corpus in any one year in the proper exercise of discretion by the trustee for the purpose of "alleviating," "aiding" and "relieving" Mrs. Wenger. Nor would it justify payment of the whole income and corpus to Mrs. Wenger, for if the events calling for distribution are sure to happen every year to every one, they will happen to the four children as well as to Mrs. Wenger; hence the money distributed should go to five persons instead of all to one. Sections 166 and 167 of the Revenue Act of 1934 make the settlor chargeable with the income of the part only of the corpus which may be revested in the grantor, and with the part only of the income which may be distributed to the grantor.

We submit that under Section G (1) (R. 42) Mrs. Wenger could use income only to the extent that the trustee might allow, and that the allowance must be limited by what in his judgment would be sufficient to alleviate, aid and relieve her from accident, sickness, calamity, adversity, bereavement or loss; and that in forming his judgment, the trustee must consider whether

the condition to be relieved amounts to a "need," or a "want," words found in Section B (R. 38), and to "suffering, want and deprivation," words found in Section C 1 (R. 38); and that the trustee's judgment must be formed in view of all the rights and interests of the children and the duty of the trustee to conserve them as gathered from all the terms of the trust instrument.

The respondent contends

(1) That the duty of the trustee to duly protect the interests of the children where payments made by the trustee to the petitioner would reduce the amounts of the trust income and corpus available for the children, does not render him substantially interested adversely to the settlor;

(2) That it is settled that a trustee has a substantial adverse interest only;

(a) if he is himself a beneficiary,

or

(b) if he has some other direct personal interest adverse to that of the settlor (Respondent's brief, p. 7).

We submit that the power of equity to compel a trustee to make good to one beneficiary any impairment of his interest in the trust funds resulting from depletion thereof by unauthorized distributions to another beneficiary does constitute a direct personal interest in the trustee, adverse to such other beneficiary.

It results in a surcharge, by the chancellor, of the trustee's account with the unauthorized distribution at the instance of the injured beneficiary, thus impairing the trustee's private fortune.

It is clear that Sections 166 and 167 are not applicable where the power to revest title to the corpus, or to hold or accumulate income, resides in a person who is adversely interested; there is nothing in these sections to the effect that if such a person is the trustee, he must not only be a person adversely interested, but he also must have the additional qualification of being a beneficiary of the trust. That the status of a beneficiary must be a qualification of such a person if the grantor is to escape the tax, was a provision of early Revenue Acts (*Cf.* Revenue Act of 1924 [43 Stat. 253] sec. 219 (g), (h); of 1926 [44 Stat. 9] Sec. 219 (g), (h); of 1928 [45 Stat. 791] Sec's. 166, 167). The Revenue Act of 1932 (47 Stat. 169) Sec's. 166, 167, dropped the status of beneficiary as the qualification, and adopted as such "a person having a substantial adverse interest," and so it now remains; and thus expressly enlarges the class of persons who may so act in conjunction with the grantor, to include a trustee who may not be a beneficiary.

III.

We submit that the cases cited by respondent in his brief at page 7 do not support his contention that the trustee's duties to the children do not endow him with a substantial adverse interest, and that he has such an interest only if he is himself a beneficiary.

The only decision of the Supreme Court cited is *Reinecke v. Smith,* 289 U. S. 172. The comments in the petitioner's brief in support of the petition for the writ at pages 16 and 17, we submit, show that that case is not in point.

In *Commissioner v. Caspersen* (C. C. A. 3) 119 F. 2d 94, the point here in issue was not considered or decided.

There, a wife granted a fund to her husband as trustee; from the income specific sums were to be paid to the wife, and from the excess of income over these specific payments, in the discretion of the trustee, a fund might be accumulated for the benefit of the minor son of the trustee and the grantor. The question presented was whether the husband-trustee was adversely interested in this excess income because of his liability to support the son. The grantor was also liable for the support of the son, and the husband-trustee was liable for her support. It was said that if these facts motivated the trustee's discretion, it was an influence in favor of, and not adverse to, the grantor. The court also found as a fact that considering all the circumstances of the case, "the trustee's interest was unsubstantial as a motive to induce him to distribute income other than as desired by the grantor-wife."

In *Altmaier v. Commissioner* (C. C. A. 6) 116 F. 2d 162, a husband granted property to his wife as trustee. The income was to be accumulated, invested and added to the corpus during the settlor's life or until his wife's death should she predecease him. Beginning at the death of the settlor, the entire net income was payable to the wife for her life; beginning with the death of the wife, the entire net income was payable to the settlor for his life. Upon the death of both settlor and wife, the trust fund was to be distributed to persons named. The case did not require the consideration of any duty of the trustee to exercise any discretion in making a distribution of income or corpus which involved conflicting interests of several beneficiaries; the questions here in issue were not there presented, considered or decided.

In *Morton v. Commissioner,* 109 F. 2d 47, 51 (C. C. A. 7), the trustee was a commercial trustee receiving $700 in

fees annually for its services; the court found this sum negligible when the size of the income and the corpus was considered, and so did not confer an adverse interest on the trustee; the trustee had power to revoke the trust instrument at any time in the exercise of which, under *Reinecke v. Smith,* the trustee owed no duty to the beneficiary. The income was to be accumulated during the continuance of the trust, and on its termination the accumulated income and all investments thereof were to be paid over to the grantor's daughter, and all the corpus to the grantor, or, if he was not alive, to other specified persons. The trustee had no questions to decide which required the exercise of his discretion and concerned conflicting interests of two or more beneficiaries. The point here in issue was not raised, discussed or decided.

In *Fulham v. Commissioner,* (C. C. A. 1) 110 F. 2d 916, a husband, as grantor, conveyed property to himself and another as co-trustees. The trust instrument provided that until the death of the grantor's wife, the trustees should accumulate the income, and also as follows: "During my [the grantor's] life, the trustees may pay to her [the wife] at any time or from time to time any part or parts or the whole of the principal and/or accumulated income of the trust fund." The trust agreement also provided for payments after the death of the wife, to the grantor's children and their issue. It also provided that a committee of three persons named, might revoke or alter the trust instrument in any way or manner, except that the committee's power to alter so as to revest in the grantor any part or all of the corpus or income was not to be exercised during the life of the wife without her consent. The court emphasized the word "may" in the provision in the trust agreement in the wife's favor. The court said that there was no criterion laid down by the trust

instrument for the guidance of the trustees in making payments to the wife on which she might under any circumstances invoke the aid of a court of equity to compel the trustees to exercise their discretion in her favor. The question of the duty of a trustee in the exercise of his discretion in making distribution to beneficiaries with conflicting interests, and the effect of his obligations arising therefrom was not presented, considered or decided.

In *Helvering v. Evans* (C. C. A. 3) 126 F. 2d 270, the grantor transferred to the Wilmington Trust Company, a Delaware corporation, as trustee, 166 shares of stock of the Journal Company. The trustee was directed to accumulate annually, and add to the corpus income in excess of $20,000 until the accumulations aggregated $1,000,000; but the annual accumulations were not to exceed one-third of the net income of any one year. The settlor during her lifetime was authorized to direct the trustee to set aside portions of the trust funds as "shares" for the benefit of her issue. That direction had never been given. The report of that case in 126 F. 2d 270, does not set out the fact which we take from the report of the case before the Board of Tax Appeals (42 B. T. A. 851) that the trust instrument directed the trustee to pay to the trustor during her life so much of the net income as was not subject to accumulation; and upon the death of the trustor, to distribute the income and the trust fund to the trustor's descendants. The trust instrument, in Section 10, also provided that "if during the continuance of this trust, the income currently payable hereunder to or for the benefit of any beneficiary, together with his or her income from other sources, should be insufficient to properly provide for the support, maintenance, benefit and/or education of such beneficiary and his or her dependents, trustee is authorized and em-

powered, in its sole discretion, to pay over, unto or for the benefit of such beneficiary so much of the principal of any part or the whole of the trust fund from which such beneficiary may then be receiving the income or the benefit thereof as may be required to make up such insufficiency of income. * * *"

The court said the term "benefit" meant "whatever promotes welfare; advantage, profit." The authority for distribution was not only for the "benefit" of the beneficiary, but also for the "benefit" of his or her dependents (not descendants).

Under the provisions of section 10, distribution was directed to be made to or for the beneficiary [*ie.* the settlor] for the "benefit" of her and her dependents of any part or the whole of the principal of the trust fund. The court, saying that "benefit" meant "whatever promotes welfare; advantage, profit", held that under that term the trustee was authorized to make distribution to the grantor "almost without limit." There was nothing in the trust instrument requiring the trustee to conserve any part of the trust fund for the benefit of the grantor's descendants and their issue; the question of the duty of the trustee in that regard, and the effect of the obligations arising therefrom, was not presented, considered or decided.

The case of *White v. Higgins* (C. C. A. 1) 116 F. 2d 312, does not support the respondent's contention. There, the settlor was a trustee with power to make himself the sole trustee, and turn over to himself all the trust property if he thought it for his welfare to do so; and thereby terminate the trust. No duty was imposed on the trustee to conserve any part of the trust property for the benefit of any other beneficiary of the trust. At most, if, in the

terms of that trust instrument any such duty could be spelled out, it was so shadowy as not to furnish any substantial ground for anticipating that the trustee would be called to account by any other beneficiary for turning over the trust property to himself. The trust instrument is described at pages 314 and 315 of the report.

At pages 7 and 8 of the respondent's brief, *Stuart v. Commissioner* (C. C. A. 7) 124 F. 2d 772, is referred to. That case decides that a trustee may have a substantial adverse interest; this met the contention that a trustee never could be substantially adversely interested based on the sentences in Art. 166-1 (b) (4), Art. 167-1 (b) (3) of Treasury Regulations 86, reading "A bare legal interest, such as that of a trustee, is never substantial and never adverse." *Stuart v. Commissioner* does not decide that a trustee can have a substantial adverse interest only when he is a beneficiary.

IV.

There is a feature of the trust instrument in this case which, so far as we are aware, makes it unique.

By Section F, the trust is to continue for fifteen years and six months from its date; provided, however, that it may be sooner terminated in one of four ways, viz:

(1) By the consent of the settlor and her four children and the trustee, evidenced by a writing signed by all persons, including the trustee whose consent is required;

(2) By consent of the settlor and the living children and the trustee evidenced by a writing signed by all, including the trustee, whose consent is required;

(3) By the death of all the children prior to the expiration of the 15½ year period;

(4) By the death of the settlor prior to the expiration of the 15½ year period, if, at the death of the settlor, all the then living children shall have reached 35 years of age and shall have received from the trustees under their father's will all the funds of the trusts of that will of which the children are beneficiaries. (For the provision of the trust instrument in this case here referred to, see section F, R. 41, 42. For the provisions of the father's will referred to, see R. 54, 55).

The trustee had a direct personal interest in the continuance of the trust and in the emoluments accruing to him therefrom. To terminate this trust by consent, application by the beneficiaries desiring the termination must be made to the trustee to sign a writing expressing his consent; the trustee may arbitrarily refuse, there is nothing in the trust instrument requiring him to base his refusal on any grounds whatever.

The trustee is entitled to whatever advantage there may be to him in the contingency that the trust will not be terminated by the death of all the children of the settlor.

Therefore, in this particular unique trust instrument, the trustee plainly had a substantial interest adverse to the settlor.

V.

In *Helvering v. Hormel* (C. C. A. 8) 111 F. 2d 1, the trustees were required to pay income up to $2,000 a year to the wife of the grantor as guardian of the grantor's children. It was held that the guardian was accountable to the children for their share of the income, and so had

a substantial interest adverse to the grantor. In the instant case the relation of the trustee to the grantor's children involves essentially the same principles as the relation of guardian and ward.

Respectfully submitted,

HENRY B. GRAVES,
Counsel for Petitioner.

CHARLES H. HATCH,
Of Counsel.